Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1994

NORTH CAROLINA POWER,
Petitioner,

v.

STATE OF NORTH CAROLINA *ex rel.*
UTILITIES COMMISSION,
Respondent.

Petition for a Writ of Certiorari to the Supreme Court of North Carolina

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PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the Supremacy Clause of the United States Constitution permits one state in setting an electric utility's retail rates to reject wholesale costs the utility was ordered to incur pursuant to a second state's determination of such wholesale costs, the second state's determination being entirely an exercise of authority over wholesale rates delegated to it by Federal law.

2. Whether the Commerce Clause of the United States Constitution permits the rejection in one state's retail rate proceeding of wholesale costs an electric utility was ordered to incur pursuant to a second state's exercise of delegated Federal authority.

PARTIES BELOW

North Carolina Power was the Appellant in Case No. 230A93 in the Supreme Court of North Carolina.

The Public Staff of the North Carolina Utilities Commission was an Appellee in Case No. 230A93 in the Supreme Court of North Carolina.

The Attorney General of North Carolina, Michael F. Easley, was an intervenor in the proceeding and an appellee in Case No. 230A93 in the Supreme Court of North Carolina.

RULE 29.1 STATEMENT

North Carolina Power is the North Carolina operating division of Virginia Electric and Power Company in North Carolina. Virginia Electric and Power Company is a wholly-owned subsidiary of Dominion Resources, Inc. Virginia Electric and Power Company has no non-wholly-owned subsidiaries.

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Petition for a Writ of Certiorari to the Supreme Court of North Carolina

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PETITION FOR A WRIT OF CERTIORARI

Petitioner North Carolina Power respectfully requests that a Writ of Certiorari issue to review the judgment of the Supreme Court of North Carolina entered in Case No. 230A93 on December 9, 1994.

OPINIONS BELOW

The opinion of the Supreme Court of North Carolina (App. 1a-21a) is reported at 338 N.C. 412 (1994) and 450 S.E.2d 896 (1994). The order of the North Carolina Utilities Commission dated February 26, 1993 (App. 24a-139a) is reported at 83 N.C.U.C. Rep. 271 (1993) and 142 P.U.R.4th 117 (1993).

JURISDICTION

The Supreme Court of North Carolina issued its opinion on December 9, 1994, and denied North Carolina Power's Petition for Rehearing on February 13, 1995

(App. 22a-23a). This Court has jurisdiction under 28 U.S.C. 1257(a).[1]

CONSTITUTIONAL AND STATUTORY PROVISIONS

The United States Constitution, Article VI, cl. 2.

> "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding."

The United States Constitution, Article I, Sec. 8, cl. 3.

> "The Congress shall have Power . . . To regulate commerce with foreign Nations, and among the several States."

The Federal Power Act, 16 U.S.C. § 824(a) (1988).

> "It is declared that the business of transmitting and selling electric energy for ultimate distribution to the public is affected with a public interest, and that Federal regulation relating to generation to the extent provided in . . . this chapter and of that part of such business which consists of the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce is necessary in the public interest."

The Federal Power Act, 16 U.S.C. § 824a-3(a) (1988).

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[1] The Supreme Court of North Carolina upheld the Commission's ratemaking order against North Carolina Power's challenge that the order violates North Carolina Power's rights under the Supremacy Clause, Article VI of the United States Constitution, and the Commerce Clause, Art. I, Sec. 8, of the United States Constitution and the Public Utility Regulatory Policies Act of 1978, 16 U.S.C. § 824a-3. State ratemaking orders are considered to be state statutes within the meaning of 28 U.S.C. § 1257. *Lake Erie & Western R.R. Co. v. Public Utils. Comm'n*, 249 U.S. 422, 424 (1919).

> The Federal Energy Regulatory "Commission shall prescribe . . . such rules as it determines necessary to encourage cogeneration and small power produciton . . . which rules require electric utilities to offer to . . . purchase electric energy from such facilities."

Regulations Under the Public Utility Regulatory Policies Act of 1978, 18 C.F.R. § 292.303(a) (1987).

> "*Obligation to purchase from qualifying facilities.* Each electric utility shall purchase, in accordance with [18 C.F.R.] § 292.304, any energy and capacity which is made available from a qualifying facility: (1) Directly to the electric utility."

Regulations Under the Public Utility Regulatory Policies Act of 1978, 18 C.F.R. § 292.401(a) (1987).

> "State regulatory authorities. Not later than one year after these rules take effect, each State regulatory authority shall . . . commence implementation of [18 C.F.R. §§ 292.301-308]. Such implementation may consist of the issuance of regulations, an undertaking to resolve disputes between qualifying facilities and electric utilities arising under [18 C.F.R. §§ 292.301-308], or any other action reasonably designed to implement [18 C.F.R. §§ 292.301-308]."

STATEMENT OF THE CASE

A. Introduction

Early in this century Congress recognized the Nation's overriding national interest in the unimpeded flow of wholesale power in interstate commerce. Congress established the Federal Power Commission (now FERC)[2] with exclusive jurisdiction over such interstate transactions because regulation by each affected State had resulted in chaos.[3] Today most of the Nation's new electric power

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[2] Federal Energy Regulatory Commission.

[3] Congress established the Federal Power Commission in 1935. 16 U.S.C. §§ 791-825 (1988). This action came in response to this

is generated, not by the traditional electric utility companies, but instead by alternative providers like cogenerators and small power producers.[4] Wholesale sales by these alternative providers are made under PURPA,[5] adopted in 1978, not under the original provisions of the Federal Power Act. Congress delegated many of the oversight functions under PURPA to the States that otherwise would be carried out by FERC. As so many of the Nation's wholesale power transactions now take place under PURPA and as the States now play important roles in the Act's implementation, it is imperative that these State administrative functions not be subverted by the chaotic piecemeal oversight that existed before the Federal Power Act was passed.

This case raises important Federal issues under PURPA over the manner in which the States are to administer the Federal decision-making authority Congress has delegated to them. Virginia Power is a multi-state electric utility whose customers reside primarily in Virginia; a much smaller percentage of its customers reside in North Caroline. A serious dispute has arisen between two states, Virginia and North Carolina, over the Federal actions

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Court's ruling in *Public Utilities Comm'n of Rhode Island v. Attleboro Steam & Electric Co.*, 273 U.S. 83, 89 (1927) (wholesale transactions between utilities in different States are interstate commerce and any State regulation of such transactions was an unlawful burden on interstate commerce).

[4] A "cogeneration facility" is one that produces both electric energy and steam or some other form of useful energy, such as heat. 16 U.S.C. § 796(18)(A) (1988). A "small power production facility" is one that has a production capacity of no more than 80 megawatts and uses biomass, waste, or renewable resources (such as wind, water, or solar energy) to produce electric power. 16 U.S.C. § 796(17)(A) (1988).

[5] The Public Utility Regulatory Policies Act of 1978, 18 U.S.C. § 824a-3 (1988). If a cogeneration or small power production facility meets the technical and ownership criteria developed by the FERC, then it is deemed to be a "qualifying facility" (QF) entitled to the benefits of PURPA. 18 C.F.R. § 292.203 (1994).

taken by Virginia in resolving a dispute between a cogenerator, Ultra Cogen Systems, Inc. (Ultra Cogen), and the utility, Virginia Electric and Power Company (Virginia Power), purchasing its electrical output under PURPA. Virginia, through its State Corporation Commission (VSCC), in 1988 decisions has implemented PURPA by imposing a requirement that Virginia Power purchase 228 megawatts[6] of cogenerated power from Ultra Cogen at $341 per kW per year for the first 15 years of the 25 year term of the contract. The VSCC determined the $341 price to be Virginia Power's "avoided costs" under PURPA, the cost Virginia Power would have incurred but for the purchase.[7] North Carolina, through its North Carolina Utilities Commission (NCUC), in a 1992 State decision, affirmed by the North Carolina Supreme Court, has subsequently reviewed the Virginia Federal decision and determined that Virginia set the price too high. North Carolina has penalized the utility by prohibiting the utility from recovering from North Carolina retail customers a large percentage of the price paid to Ultra Cogen. The disallowance is $1.39 million per year for the 15 year period.

The North Carolina Utilities Commission recognized that the electric utility was being made the sacrificial lamb by the conflicting actions of the two States:

> This Commission also recognizes the position of Vepco. It is "caught in the middle" between our

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[6] The VSCC orders addressed four plants with a maximum dependable capacity of 57 mW each. At the time of the North Carolina decision, three plants were in operation with a maximum dependable capacity of 62.7 mW each.

[7] A rate for purchase is consistent with Federal law if the rate equals the utility's avoided costs. 18 C.F.R. § 292.304(a)(2) (1994). Avoided costs has been defined by FERC as "the incremental costs of an electric utility of electric energy or capacity or both which, but for the purchases from the qualifying facility or qualifying facilities, such utility would generate itself or purchase from another source." 18 C.F.R. § 292.101(b)(6) (1994).

> decision and that of the Virginia SCC, but that is not unique to this issue. That is an inevitable consequence of doing utility business across state lines.

App. 75a.

North Carolina's collateral attack upon the Virginia Federal decision raises a serious Federal preemption issue. North Carolina's decision squarely conflicts with this Court's decisions in *Nantahala Power & Light Co. v. Thornburg*[8] and *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*.[9] Ultra Cogen's sales of power to Virginia Power clearly are wholesale sales in interstate commerce. Virginia Power includes its purchases from Ultra Cogen within its power supply obtained from other sources, including its own generation and purchases on the interstate power grid. Virginia Power sells power from all of these sources at retail in North Carolina and Virginia, as well as at wholesale to other suppliers in other States through the interstate grid.

Upon the passage of PURPA, Congress carved out an exception to FERC's exclusive jurisdiction over wholesale sales in interstate commerce.[10] Under PURPA, Congress authorized the States to resolve disputes such as the dispute that arose between Ultra Cogen and Virginia Power.[11] As States have no jurisdiction over wholesale sales of power in interstate commerce but for PURPA,

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[8] 476 U.S. 953 (1986).

[9] 487 U.S. 354 (1988).

[10] The relevant section of PURPA here is Section 210, 18 U.S.C. § 824a-3 (1988), which concerns cogeneration. App. 195a-197a.

[11] State regulators have been required to create and enforce arrangements between wholesale purchasers of electricity and wholesale sellers, including cogenerators. 18 C.F.R. § 292.401(a) (1987). The means of such enforcement "may consist of the issuance of regulations, an undertaking to resolve disputes between qualifying facilities and electric utilities arising under Subpart C, or any other action reasonably designed to implement such subpart." *Id.* (App. 202a).

and as States are only implementing PURPA when resolving disputes between qualifying facilities and electric utilities under mandatory guidelines promulgated by FERC, the actions exercised by the States in this area are Federal ones and not State ones.

This Court, in its recent *Nantahala* and *Mississippi Power* decisions, cogently has reaffirmed the longstanding principle that once a Federal wholesale for resale rate has been established pursuant to appropriate Federal authority, no State can collaterally attack and undermine the Federally-established rate by refusing to recognize the wholesale costs in establishing retail rates.

The issue before the North Carolina Supreme Court was whether the Virginia Commission's order requiring Virginia Power to buy power from Ultra Cogen, a sale Virginia Power wished to avoid, at a price above the price Virginia Power sought to pay, was the equivalent of a FERC decision establishing wholesale for resale costs for purposes of applying this Court's rulings in *Nantahala* and *Mississippi Power*. If it was, North Carolina was bound by the Supremacy Clause to honor the Virginia decision.

The North Carolina Supreme Court acknowledged this Court's holdings in *Nantahala* and *Mississippi Power* but circumvented the Court's rulings by challenging the Virginia Commission's characterization of its own actions and by reclassifying the price set by Virginia as a price "in excess of avoided cost." Such blatant disregard of this Court's pronouncements by the very court that was reversed in *Nantahala* should not go unaddressed.

The North Carolina court's reclassification of the Virginia Commission's actions to avoid the holdings of this Court in *Nantahala* and *Mississippi Power*, if allowed to stand, will seriously undermine PURPA. The North Carolina court's reclassification has the effect of rendering the Federal decision that established the price a qualify-

ing facility may charge unenforceable beyond the State lines of the State rendering the Federal decision.

By its rulings, North Carolina has ignored the Federal decision of its sister State and has taken steps to shield North Carolina citizens affected by the Federal decision from paying costs that must be borne by the remainder of the utility's consumers in other States. North Carolina's actions, if left unrectified, seriously undermine the Congressional intent that States render Federal decisions in implementing PURPA. If the utility can be "caught in the middle" (App. 75a) as North Carolina asserts, then North Carolina's actions deal a serious blow to the Congressional desire that purchases of power from alternative suppliers like Ultra Cogen be encouraged.

B. Background

1. *The Virginia Arbitration.*

Ultra Cogen sought to develop a number of qualifying facilities (QFs) in the service territory of Virginia Power in Virginia. App. 2a-3a, 62a. Ultra Cogen engaged in unsuccessful negotiations with Virginia Power for the sale of the electrical output from its QFs. App. 62a. Virginia Power was unwilling to pay the price Ultra Cogen proposed. Between November 12, 1987, and December 3, 1987, Ultra Cogen filed petitions before the VSCC pursuant to 16 U.S.C. § 824a-3(f)(1) asking the Virginia Commission to arbitrate this dispute over Virginia Power's obligation to purchase the cogenerated power and the price the utility should pay. App. 63a, 177a.

Before this dispute arose, in January 1983 and November 1985, the VSCC had issued orders stating that it would arbitrate disputes between qualifying facilities and electric utilities who could not agree upon acceptable contractual arrangements. App. 166a, 203a, 213a. These orders were issued to comply with FERC's regulations that State commissions implement PURPA by "undertaking to resolve disputes between qualifying facilities

and electric utilities . . ." 18 C.F.R. § 292.401(a) (1987). App. 166a n.1. Pursuant to these orders, the VSCC undertook to arbitrate the dispute between Ultra Cogen and Virginia Power. By an order issued February 26, 1988, the VSCC designated one of its members, Judge Thomas P. Harwood, Jr., as arbitrator. The pertinent issue in the arbitration was the price to be paid to Ultra Cogen by Virginia Power, as measured under PURPA by Virginia Power's "avoided costs." App. 164a-168a.

At the time of the arbitration, Virginia Power was in the process of implementing a procedure under which it would solicit bids from qualifying facilities so as to establish avoided costs as the lowest acceptable bid, rather than as the projected costs of power from plants the utility would construct itself. App. 173a. This latter method had been the traditional process for determining avoided costs used by Virginia Power and repeatedly accepted by the VSCC as an appropriate method for determining avoided costs. This traditional method was referred to as "administratively determined avoided costs." In its February 26, 1988 order requiring arbitration, the VSCC commented that Virginia Power could solicit bids but that any such solicitations would be specifically subject to the Ultra Cogen arbitration. App. 168a.

Before Judge Harwood, Virginia Power argued that the solicitation procedure would produce avoided costs lower than the administratively determined avoided costs and urged him to determine the avoided costs to be paid to Ultra Cogen through reference to the competitive bids received in a 1988 or alternatively to an earlier 1986 solicitation. App. 173a. Ultra Cogen argued that the avoided costs determined through the competitive bid process could not be used. In order to resolve these differences, the arbitrator looked to FERC rulings and regulations for guidance. App. 171a-173a.

Judge Harwood determined that 18 C.F.R. § 292.304 (d)(2) (1987) allows the qualifying facility to choose

to have the price established at (a) the date the energy is available, or (b) the date on which a legally enforceable obligation is established. The arbitrator determined that Ultra Cogen, through its petition, had selected (b), the date of the legally enforceable obligation, which he determined to be November 12, 1987, the date the first petition for arbitration was filed. App. 171a-172a. Thus, the date for determining avoided costs to be paid Ultra Cogen was specifically decided by Judge Harwood.

Next, Judge Harwood decided whether the basis for determining avoided costs would be administratively determined or determined by reference to competitive bids. App. 172a-173a. Judge Harwood expressly rejected Virginia Power's position that resort should be made to the then upcoming bidding procedure to determine avoided costs.[12] Because he had ruled that 18 C.F.R. § 292.304 required that the price be established on November 12, 1987, Judge Harwood found that "the figures related to Virginia Power's [1988 solicitation] are not known even today, and will not be known for some time. This matter must be resolved now, however, and not at some indefinite future date." App. 173a. Judge Harwood thus ruled that Virginia Power's avoided costs on November 27, 1987, were the costs of constructing and operating Virginia Power's power plant, Chesterfield No. 7, as projected on November 12, 1987. This plant was intended by the Company to be the prototype of any new capacity to be built by the Company through the mid 1990s. App. 172a-173a.

By interim order issued May 27, 1988, the arbitrator identified the capacity cost based on his earlier rulings to be $341.23 per kW per year and ordered the parties to execute contracts incorporating that price. App. 178a-

[12] The VSCC formalized the use of the bidding procedure in its Rules Governing the Use of Bidding Programs to Purchase Electricity from Other Power Suppliers in its Final Order in Case No. PUE900029 (November 28, 1990), almost two years after its Arbitration Order in this proceeding.

179a. On September 30, 1988, the parties submitted the contracts, and on the same date the arbitrator approved them. App. 189a-190a. By order issued November 18, 1988, the VSCC ratified and adopted the arbitrator's determinations. App. 192a. Virginia Power did not appeal that order. Subsequent to the order, three of the Ultra Cogen plants have been completed, and Virginia Power has been buying power from them at the prices required by the VSCC. App. 65a. The annual capacity costs are $64 million. App. 62a.

2. *The North Carolina Utilities Commission Proceedings.*

In 1992 Virginia Power, which operates as North Carolina Power in North Carolina, filed for an increase in its North Carolina retail rates before the North Carolina Utilities Commission. The Commission's Public Staff advocated disallowance of $1.39 million per year of the $2.8 million Ultra Cogen capacity payments allocated to North Carolina.[13] App. 66a.

The NCUC disallowed the $1.39 million. The NCUC recited the history leading to the signing of the Ultra Cogen-Virginia Power contracts including Virginia Power's attempt to persuade the arbitrator to set a lower price. App. 61a-65a. The NCUC noted that at approximately the same time Virginia Power signed the contracts with Ultra Cogen, it was signing contracts with cogenerators whose bids were selected in the 1988 solicitation. Seven of those projects were on line with capacity payments averaging $171 per kW. App. 65a. The NCUC disallowed the difference between the $341 per kW paid

[13] All capacity and energy sold by Ultra Cogen is acquired by Virginia Power in Virginia. Thereafter this power loses its identity and is intermixed with power from all of the Company's other sources of generation. Power Virginia Power sells in North Carolina comes indiscriminately from these combined sources. The percentage of the costs of the combined sources of power charged in North Carolina is determined by allocation factors approved by the North Carolina Utilities Commission.

Ultra Cogen and the $171 per kW average capacity price paid to these seven cogenerators. App. 72a-73a. The NCUC's disallowance was based on its belief that the price to be paid Ultra Cogen should have been based on competitive bids received in the year following the filing of the arbitration. App. 69a, 72a. The VSCC, of course, had rejected the use of competitive bids, which had been put forward by Virginia Power, as being inconsistent with FERC regulations. The NCUC ignored the VSCC justification for rejecting this position and did not address the FERC regulations at issue.

The NCUC stated that although States are to implement PURPA by resolving disputes over the obligation to buy and over price (App. 67a), as had Virginia, FERC did not seek to divest from regulatory agencies of other States the authority subsequently to review cogeneration contracts as part of their regulation of electric utilities. App. 68a. The NCUC noted that FERC regulations suggested that States could authorize prices in excess of avoided costs on the basis of State, not Federal, authority, and that Virginia at one time in the past had authorized a 15% rider above avoided costs (the NCUC, however, recognized that no 15% rider was added to the price paid Ultra Cogen).[14] App. 68a. The NCUC ruled

[14] The NCUC mischaracterized the 15% "rider." Its lone appearance in Virginia was in the VSCC order dated November 15, 1985, in which the VSCC set rates Virginia Power was required to pay qualifying cogeneration and small power production facilities under its Schedule 19 tariffs. App. 213a. The rider was not for an amount above avoided costs but was simply an attempt by the VSCC to determine elements of the utility's avoided costs that were not easily measured. The VSCC mentioned that such elements included the benefit from the reduction of use of fossil fuels, the deferral of major capacity additions by utilities, shorter construction lead times, and system reliability. The VSCC considered it its duty under PURPA to give reasonable weight to such intangible factors, "bearing in mind the mandate of PURPA that cogeneration and small power production is to be encouraged." Upon Virginia Power's motion for reconsideration of the order, the VSCC on December 6, 1985 (App. 229a), made it clear that "we did not hold,

that PURPA did not preempt North Carolina from making the disallowance. It held:

> "[A]voided costs" can be determined quite differently by different jurisdictions. Further, PURPA does not preempt this Commission's authority to review QF contracts in setting rates for the electric utilities operating in North Carolina. This Commission, in setting rates for NC Power in North Carolina, is not bound to interpret PURPA in the same manner as the Virginia SCC or to provide for the SCC's consideration of benefits unique to Virginia.

App. 68a.

The NCUC further ruled:

> The issue to be decided is whether the level of expense for the capacity associated with the [Ultra Cogen] projects is reasonable for ratemaking purposes in North Carolina. The Commission concludes that it is not.

App. 72a. The NCUC found that the capacity payments to Ultra Cogen were "out of line" with "other contemporaneous measures of avoided costs." App. 72a-73a.

The NCUC concluded:

> [I]t may be reasonable for Virginians to pay the extra costs associated with the [Ultra Cogen] projects. But it is unreasonable for North Carolinians to pay such extra costs, and our responsibility is to set fair and reasonable rates for North Carolina. We cannot accept the assumption implicit in the Com-

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nor did we intend to suggest, that any QF is to be paid more than full avoided costs, for any reason." Further, the VSCC stated that its "holdings on rate levels were intended to match, not exceed, avoided costs." In order to clarify its November 15, 1985 order, and "consistent with [its] view that no QF should receive more that full avoided costs," the VSCC amended its November, 1985 order so as to include language that would "eliminate the potential for any QF to receive payments in excess of full avoided capacity costs." App. 232a.

> pany's position that our authority to set rates for North Carolina—and, by extension, the authority of the North Carolina Supreme Court—is circumscribed by the decision of an arbitrator in Virginia.[15]

App. 74a.

3. *The North Carolina Supreme Court's Decision.*

The North Carolina Supreme Court upheld the NCUC decision. It stated:

> The North Carolina Utilities Commission carefully reviewed the capacity rate set by the Virginia arbitrator's decision and found that he did not properly take into account other potential sources of power [those provided in the 1988 solicitation]. Thus, the Virginia arbitrator greatly overestimated NC Power's avoided costs. The North Carolina Utilities Commission's exclusion of $1.39 million in expenses for capacity payments for the Ultra Cogen cogeneration projects is nothing more than the disallowance of the amount by which the contract rate exceeded NC Power's avoided costs. Therefore, there is no violation of PURPA.

App. 9a.

The North Carolina Supreme Court acknowledged that "the VSCC was required to apply the avoided-cost rule in determining wholesale rates pursuant to PURPA and FERC regulations." App. 5a. However, in response to the argument that the VSCC was doing just that and thus the NCUC had unlawfully interfered with the implementation of Federal law, the North Carolina court summarily concluded: "We disagree." App. 5a.

The North Carolina court acknowledged that *Nantahala* and *Mississippi Power* establish the preemptive effect of

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[15] One Commissioner dissented: "I would hold that to disallow the recovery of costs actually incurred, we would need to find a lack of reasonable and prudent action on the part of North Carolina Power." App. 137a.

wholesale rates established pursuant to Federal authority. App. 6a. The court ruled, however, that because the VSCC had established a price above avoided costs, *Nantahala* and *Mississippi Power* did not apply. App. 6a.

Secondly, the North Carolina court ruled that the NCUC's disallowance did not violate the Commerce Clause. The court reasoned that the NCUC acted in a manner consistent with PURPA and the FERC regulations. App. 10a-11a. The court recognized that although "inconsistent determinations of avoided costs by the VSCC and the [NCUC] may burden NC Power, we believe this burden is a necessary consequence of doing business in more than one state." App. 11a. The court concluded that by not appealing the order of the VSCC, Virginia Power assumed the risk that the NCUC would not allow it to recover the "excess amount" from North Carolina ratepayers. App. 11a.

Two Justices dissented, arguing that the NCUC's actions were preempted by PURPA. The dissenters stated that the VSCC was acting pursuant to Federal law when it set rates for the Ultra Cogen purchases and that Virginia Power's obligation to pay the VSCC rate was a Federal obligation incurred pursuant to PURPA. The dissenters concluded that this Court's holdings in *Nantahala* and *Mississippi Power* controlled. Thus, the VSCC order was binding on the NCUC. App. 14a-21a.

REASONS FOR GRANTING THE PETITION

I. PURPA PREEMPTS NORTH CAROLINA'S APPLICATION OF ITS STATUTES.

A. This Case Raises Important Federal Issues.

In 1978, Congress enacted PURPA to prompt development of alternative energy sources to reduce the Nation's dependence upon oil and gas. PURPA encourages traditional electric utility companies to purchase power produced by alternative suppliers such as cogenerators to replace power generated by burning traditional fossil fuels. In turn, utilities sell their power to end-user customers at retail. Since the passage of PURPA, the Nation's electric utilities have entered into thousands of agreements with alternative suppliers and have purchased billions of dollars of electricity from these sources.

Like many of the Nation's large electric utilities, Virginia Power has drastically curtailed the construction of large fossil fuel and nuclear generating plants and has turned increasingly to alternative suppliers such as Ultra Cogen.[16] While Virginia Power has been in the forefront in responding to PURPA, it is by no means alone. Since 1990 most of the Nation's new capacity has been supplied by alternative suppliers, and more new sources of power have been constructed by qualifying facilities than by traditional utilities.[17]

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[16] William W. Berry, *Competition in the Electric Industry: The Influence of PURPA, PUHCA, and Transmission Access*, ABA Section of National Resources Law Report (Fall, 1991).

[17] It has been estimated that non-utility generators (NUGs) accounted for more than 63% of all the on-line capacity added nationwide in 1992. In 1991 and 1992 together, of the 6500 mW of generating capacity created in the United States, 4100 mW were added by NUGs; only 700 mW of new generation were reported by investor-owned utilities such as Virginia Power, while 1700 mW were added by municipal and rural cooperative systems. Further, although in 1992 it was estimated that QFs in the United States already possessed the massive total cumulative capacity of more

Appropriate and fair implementation of PURPA is essential because so much of the Nation's electric production capacity is now being supplied through alternative suppliers. Appropriate and fair resolution of disputes over prices paid to alternative suppliers is essential because this is the crucial factor in insuring that PURPA's goals of fairness to the alternative supplier and the utilities' ratepayers are fulfilled.[18] The number of disputes related to QF/utility contracts and the financial consequences flowing from their resolution has increased dramatically in recent years and will continue to increase.[19]

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than 82,000 mW, it was reported that QF filings in 1993 alone increased by more than 88% over 1992, to almost 12,000 mW. Jim Rossi, *Making Policy Through the Waiver of Regulations at the Federal Energy Regulatory Commission*, 47 Admin. L. Rev. 255, 257-58, 291 n.172 (1995).

[18] The most important obligation of the States in the implementation of PURPA has been the duty to set rates for purchases of electricity from cogenerators by electric companies. 18 C.F.R. § 292.304 (1994).

[19] Recent disputes involve analogous attempts to revisit the price utilities pay qualifying facilities pursuant to contracts approved in past years. In *Freehold Cogeneration Associates, L.P. v. Bd. of Regulatory Comm'rs of New Jersey*, 44 F.3d 1178 (3rd Cir. 1995), the Third Circuit held that the New Jersey regulators' implementation role under PURPA ended with its initial approval of the sales contract. The court stated: "there is specific federal statutory legislation, PURPA, that bars reconsideration of the prior approval of the [purchase power agreement] at least absent some basis in the law of contracts for setting aside the [purchase power agreement]." 44 F.3d at 1192.

FERC has also recently stated that the "appropriate time to challenge a state-imposed rate is up to or at the time the contract is signed, not several years into a contract which heretofore has been satisfactory to both parties." *Connecticut Light & Power*, 70 FERC ¶ 61,013, at pp. 61,029-30 (1995). *See also New York State Electric & Gas Co.*, 71 FERC ¶ 61,027 (1995) (denying after-the-fact petition to recover payments made in excess of avoided cost).

Similarly, in *Wilson v. Harlow*, 860 P.2d 793 (Okla. 1993), *cert. denied*, —— U.S. ——, 114 S.Ct. 1067, 127 L.Ed.2d 386 (1994), a utility customer brought a state common law breach of fiduciary

Through PURPA, Congress delegated to the States a number of administrative functions subject to FERC oversight. Congress required FERC to promulgate rules under which these administrative functions were to be carried out.[20] One important function Congress delegated to the States under FERC regulations was to settle disputes over the utilities' obligation to buy the alternative providers' power and disputes over the price of such power.[21]

Under the Federal Power Act and the Supremacy and Commerce Clauses of the United States Constitution, FERC decisions establishing obligations and prices of

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duty claim against directors of a public utility for the directors' failure to rescind a contract between the utility and a cogenerator on the ground that the contract would unnecessarily cost the utility's ratepayers more than $2 billion. The contract had been approved by the Oklahoma Corporation Commission acting pursuant to PURPA. The Oklahoma Supreme Court found that such an action was preempted by PURPA:

> The Directors could not comply with federal mandates to honor long term, fixed rate contracts with cogenerators, while at the same time being required to rescind any such contract which, due to changed circumstances, became undesirable to ratepayers. Imposing such a fiduciary duty would thwart the objectives and purpose of Congress. PURPA was enacted to encourage electric utilities to purchase energy from cogenerators.

Wilson, 860 P.2d at 799. *See also Smith Cogeneration Management, Inc. v. Oklahoma Corp. Comm'n*, 863 P.2d 1227 (Okla. 1993) (finding state commission rule requiring QFs and electric utilities to include in their contracts a provision allowing the state commission to reconsider and modify the rates of such agreement to be preempted by PURPA because such a provision discourages cogeneration).

North Carolina's decision, while squarely in conflict with these decisions, goes considerably beyond the activities found preempted. Not only has North Carolina altered the impact of the qualifying facility-utility contract, it has refused to reduce the price the qualifying facility receives and has instead "trapped the costs," forcing Virginia Power to absorb them.

[20] 16 U.S.C. § 824a-3(a) (1988).

[21] 18 C.F.R. § 292.401 (1987).

wholesale power are binding on the States where the wholesale power is resold to end users. For PURPA to work, regulatory decisions made under PURPA establishing the obligation to purchase and the price of wholesale power must likewise be immune from collateral attack and disregard by the States in which the wholesale power is resold to the end user. As so much wholesale power now is provided by alternative suppliers covered by PURPA, and as many of the large utilities sell power in more than one State, decisions affecting wholesale power transactions under PURPA must receive the same protection as decisions affecting non-PURPA wholesale power transactions. The principles of Federal supremacy, which *Nantahala* and *Mississippi Power* made clear, will be severely undermined unless States are required to honor Federal decisions in implementing PURPA.

B. The Decision of the North Carolina Supreme Court Is in Conflict With This Court's Decisions.

In 1935 Congress recognized that there should be a single agency with exclusive jurisdiction over interstate transactions because such transactions affect more than one State, and regulation by each affected State would invite chaos.[22] Because all States would seek to advance "their respective local interests," the likely result would be inconsistent State determinations that would either prevent interstate wholesale producers from recovering all of their costs or unfairly shift costs among affected States.[23] Congress thus drew "a bright line easily ascertained" to

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[22] *See* 16 U.S.C. § 824 (1988), Section 201 of the Federal Power Act (194a-195a). The primary purpose of Section 201 of the Federal Power Act was to give the Federal Power Commission authority that was denied the States—the authority to regulate the sale of electric energy at wholesale in interstate commerce. *Jersey Central Power & Light Co. v. Federal Power Comm'n*, 319 U.S. 61, 67-68 (1943).

[23] *Public Utilities Comm'n of Rhode Island v. Attleboro Steam & Electric Co.*, 273 U.S. 83, 89-90 (1927).

divide State and Federal regulatory authority.[24] Under this "bright line," States are prohibited from regulating those bulk power supply arrangements among utilities, regardless of the actual "impact of state regulation upon the national economy."[25]

In 1978 Congress enacted PURPA to encourage sales from alternative suppliers. Congress' intent was to promote power production that reduced reliance on fossil fuels.[26] But PURPA's encouraged transactions are wholesale, interstate transactions that only the FERC was authorized to oversee. In order to assuage concerns that passage of PURPA would unduly restrict State retail rate decision-making, Congress delegated to the States authority to resolve disputes between alternative providers and the electric utilities.[27] Congress directed FERC to promulgate mandatory regulations under which the States were to exercise this Federal authority.[28]

Importantly, PURPA carved out an exception to FERC's exclusive jurisdiction over wholesale interstate power transactions. Equally important, the authority the States exercise in administering PURPA is Federal, not State. Also, by its delegation to States of Federal authority to oversee wholesale transactions, Congress did nothing to minimize the importance of a unified, national

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[24] *Federal Power Comm'n v. Southern California Edison Co.*, 376 U.S. 205, 215-16 (1964).

[25] *Id.*

[26] *Federal Energy Regulatory Comm'n v. Mississippi*, 456 U.S. 743, 745-46 (1982).

[27] 124 Cong. Rec. H35002 (daily ed. October 10, 1978) ("The conference substitute does not change the primary responsibility of the States with respect to [retail] electric utility rates, but it places Federal responsibilities and obligations on the State commissions in the exercise of their responsibilities and on utilities within the States which are not otherwise regulated by State Commissions.").

[28] 16 U.S.C. § 824a-3(a) (1988).

policy concerning wholesale interstate power transactions. The dangers from regulation by each State of disputes over wholesale transactions are the same whether the transaction is covered by the original provisions of the Federal Power Act or PURPA.

When Virginia required Virginia Power to purchase power from Ultra Cogen and pay Ultra Cogen $341 per kW, Virginia was making a Federal decision, not a State one. The Virginia decision fixed an obligation and a rate affecting wholesale interstate power. The power Virginia Power purchases from Ultra Cogen is intermixed with Virginia Power's other sources of wholesale power and power from its own generation resources. Virginia Power draws upon these intermixed sources of power to fulfill its commitment to users in North Carolina and Virginia.

By contrast, when North Carolina disallowed recovery of $1.39 million per year of the price Virginia Power pays Ultra Cogen, North Carolina was exercising State authority, not its Federal authority delegated to it under PURPA from Congress. North Carolina was engaged in traditional retail ratemaking under authority granted to it by the State legislature.

In *Nantahala Power and Light Co. v. Thornburg*,[29] this Court addressed whether a State in establishing retail electric rates to be paid by its citizens was bound by FERC's determinations establishing wholesale power allocations and costs. FERC had examined wholesale power agreements determining how much low cost entitlements power Nantahala should receive. This determination greatly affected Nantahala's wholesale power costs. The North Carolina Utilities Commission, in establishing Nantahala's retail rates, determined that Nantahala received too few entitlements under a FERC approved allocation and refused the utility recovery of a large percentage of its wholesale power costs.

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[29] 476 U.S. 953 (1986).

This Court reversed the North Carolina Supreme Court's affirmance of the NCUC. This Court found North Carolina's actions preempted under the Supremacy Clause and determined that once FERC sets a wholesale rate, a State may not conclude that the FERC-approved wholesale rate is unreasonable. The Court held:

> "[T]here can be no divided authority over interstate commerce, and . . . the acts of Congress on that subject are supreme and exclusive." Consequently, state efforts to regulate commerce must fall when they conflict with or interfere with Federal authority over the same activity.[30]

The Court also held that in establishing retail rates:

> A State must . . . give effect to Congress' desire to give FERC plenary authority over interstate wholesale rates, and to ensure that States do not interfere with this authority.
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> * * *
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> "Congress meant to draw a bright line easily ascertained, between state and federal jurisdiction, making unnecessary such case-by-case analysis. This was done in the Power Act by making FPC jurisdiction plenary and extending it to all wholesale sales in interstate commerce except those which Congress has made explicitly subject to regulation by the States."
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> * * *
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> When FERC sets a rate between a seller of power and a wholesaler-as-buyer, a State may not exercise its undoubted jurisdiction over retail rates to prevent the wholesaler-as-seller from recovering the costs of paying the FERC-approved rate. . . . Such a "trapping" of costs is prohibited. Here, Nantahala cannot fully recover its costs of purchasing at the FERC-approved rate if NCUC's order is allowed to stand.[31]

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[30] 476 U.S. at 964 (citations omitted).

[31] 476 U.S. at 966, 970 (citations omitted).

In this case North Carolina's actions have again "trapped" Federally determined wholesale costs, just as in *Nantahala*. As in *Nantahala*, North Carolina is exercising its jurisdiction over retail rates to prevent a wholesaler-as-seller from recovering costs of paying a Federally-established rate. The only distinction between *Nantahala* and the facts presented by this case is that Virginia, acting on authority delegated to it by Congress through PURPA under mandatory FERC guidelines, rendered the Federal decision instead of FERC acting pursuant to the Federal Power Act.[32]

Any argument that this distinction renders *Nantahala* inapplicable is unavailing. This Court has determined that § 210 of PURPA [33] constitutionally requires States to implement the Federal Act in the manner Virginia has here. In *Federal Energy Regulatory Comm'n v. Mississippi* [34], Mississippi challenged PURPA's Title I and III and § 210 as being beyond the scope of the Commerce Clause and an invasion of State sovereignty in violation of the Tenth Amendment. In rejecting the Commerce Clause argument this Court held:

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[32] The decision of the VSCC was also impliedly affirmed by FERC. In *Doswell Limited Partnership*, 50 FERC ¶ 61,251 at p. 61,758 (1990) (App. 140a), the FERC specifically referenced the order of the VSCC adopting the findings of the arbitrator in the Ultra Cogen proceeding in holding that the proposed rates of the applicant in the FERC proceeding, Doswell Limited Partnership, did not exceed Virginia Power's avoided cost under PURPA. Citing the VSCC's order, the FERC concluded: "That Chesterfield 7 was an accurate representation of Virginia Power's avoided cost is corroborated by the Virginia Commission's adoption of Chesterfield 7's costs to set avoided costs rates for certain of contracts in the same time frame involved here." *Id.* This statement makes the case remarkably similar to *Nantahala*, particularly in that it demonstrates that the VSCC's actions were appropriate avoided costs determinations under Federal law.

[33] 16 U.S.C. § 824a-3 (1988).

[34] 456 U.S. 742 (1982).

> [I]t is difficult to conceive of a more basic element of interstate commerce than electric energy, a product used in virtually every home and every commercial or manufacturing facility. No state relies solely on its own resources in this respect. . . . Indeed, the utilities involved in this very case . . . sell their retail customers power that is generated in part beyond Mississippi's borders. . . . The intrastate activities of these utilities, although regulated by the Mississippi Public Service Commission, bring them within the reach of Congress' power over interstate commerce.
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> It is not for us to say whether the means chosen by Congress represent the wisest choice. It is sufficient that Congress was not irrational in concluding that limited federal regulation of retail sales of electricity and natural gas, and of relationships between cogenerators and electric utilities, was essential to protect interstate commerce.[35]

With respect to the Tenth Amendment challenge, this Court ruled:

> Clearly, Congress can pre-empt the States completely in the regulation of retail sales by electricity and gas utilities and in the regulation of transactions between such utilities and cogenerators.[36]

This Court specifically addressed the kind of action performed by the VSCC in this case, an arbitration and order setting wholesale rates:

> The statute's substantive provisions require electricity utilities to purchase electricity from, and to sell it to, qualifying cogenerator and small power production facilities. . . Yet FERC has declared that state commissions may implement this by, among other things, "an undertaking to resolve disputes between qualify-

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[35] 456 U.S. at 757-58 (citations omitted).

[36] 456 U.S. at 759.

> ing facilities and electric utilities arising under [PURPA]." [37]

Regarding the State's duty to resolve disputes, this Court further held that:

> [S]tate courts have a unique role in enforcing the body of federal law. . . . Thus the state courts were directed to heed the constitutional command that "the policy of the federal Act is the prevailing policy in every state . . . and should be respected in the courts of the State."
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> So it is here. The Mississippi Commission has jurisdiction to entertain claims analogous to those granted by PURPA, and it can satisfy § 210's requirements simply by opening its doors to claimants. That the Commission has administrative as well as judicial duties is of no significance. Any other conclusion would allow the States to disregard both the preeminent position held by federal law throughout the Nation, . . . and the congressional determination that the federal rights granted by PURPA can appropriately be enforced through state adjudicatory machinery. Such an approach, *Testa* emphasized, "flies in the face of the fact that the States of the Union constitute a nation," and "disregards the purpose and effect of Article VI of the Constitution." [38]

Based on this precedent, Virginia had full authority to render the Federal decision, and, having done so, North Carolina was bound to adhere to it just as though FERC itself had acted.

North Carolina's path in circumventing the preemptive reach of the Federal decision rendered by the Virginia Commission is equally unavailing. The North Carolina Supreme Court states that Virginia's establishment of costs is not binding on North Carolina to the extent Virginia establishes capacity costs above $171 per kW because any

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[37] 456 U.S. at 759-60 (citations omitted).

[38] 456 U.S. at 760-61 (citations omitted).

authorization above $171 exceeds "avoided costs." App. 6a. The North Carolina court suggests that any requirement that Virginia Power pay a price above $171 per kW is action that contravenes PURPA because PURPA prohibits prices above avoided costs. App. 8a-9a. The North Carolina court implies that such an "in excess of avoided cost" determination is based on State, not Federal, authority. App. 4a-5a.

North Carolina's analysis of the Virginia decision establishing the utility's obligation to buy power from the qualifying facility and the price to be paid for the power raises an important Federal preemption issue. In its orders, the Virginia Commission unequivocally stated that it was establishing price as the avoided cost of the utility as required by PURPA and in accordance with mandatory FERC guidelines. App. 171a-172a.

The Virginia Commission faced conflicting recommendations as to price. The qualifying facility owner argued for a price based on an administratively determined avoided cost; the utility sought to base the price on avoided costs determined in a competitive bid process. In resolving the dispute, the Virginia Commission applied FERC regulations. App. 172a. The Virginia Commission interpreted the regulations to require that avoided costs be established on the date the utility's obligation to buy the power was established, held to be the date the qualifying facility filed its petition to arbitrate. The Virginia Commission also found that an administratively determined avoided cost was the proper method for computing the price to be paid Ultra Cogen. App. 172a-173a, 178a. The Virginia Commission expressly followed PURPA in making a Federal decision. North Carolina is attempting to escape its obligation to honor the Federal decision by recasting the Virginia decision from a Federal mandate into a State action against the issuing State's wishes.

Both the NCUC and the North Carolina Supreme Court are tellingly silent on the interpretation of the FERC reg-

ulation that establishes the date on which avoided costs must be determined.[39] North Carolina cannot ignore FERC's requirement of determining the timing of the avoided costs. Virginia ruled that the determination had to be made on November 12, 1987. App. 172a-173a. On that date, bids from the subsequent 1988 solicitation were not known and therefore could not be used. North Carolina simply pretends that the timing regulation does not exist. This omission reveals that North Carolina's labeling of the Virginia decision as an "in excess of" avoided cost decision is completely invalid under Federal law.

The North Carolina decision deals a serious blow to PURPA. PURPA simply will not work if one State, exercising Federal authority, establishes a price an electric utility must pay a cogenerator, and a second State, exercising State retail ratemaking authority, denies the utility recovery of or "traps" a portion of the costs. Utilities, such as Virginia Power, to whom PURPA's provisions are directed, most certainly will be discouraged from buying power from alternative suppliers when one State can require them to buy power at a mandated price and then another State can refuse to permit reimbursement of the mandated price through recovery in retail rates. If the North Carolina decisions are allowed to stand, a multistate utility would be forced to obtain approvals of avoided cost rates to be paid to a qualifying facility in each of the States in which it serves. These redundant approvals certainly would lead to significant delays in the execution of a contract between the utility and qualifying facilities and would significantly discourage the development of those facilities to the detriment of the goals of PURPA.

Although Virginia Power has accepted its responsibilities under PURPA, the North Carolina Utilities Commission lightly dismissed the agency's obligations. "In making this decision, we recognize our obligation to encour-

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[39] 18 C.F.R. § 292.304(d)(2) (1994).

age QFs, but that is not the issue here. The issue here is ascertaining reasonable operating expenses for purposes of setting just and reasonable rates in North Carolina." App. 74a. Such lip service to PURPA, while requiring the utility to absorb $1.39 million annually of the payment made to the qualified facility in order to protect North Carolina ratepayers, is prodigal stewardship of North Carolina's responsibilities under PURPA that should be reviewed by this Court.

II. NORTH CAROLINA'S RULINGS VIOLATE THE COMMERCE CLAUSE.

Despite the substantial burden placed on interstate wholesale power transactions, the North Carolina court held that the trapping of costs by inconsistent decisions under PURPA does not violate the Commerce Clause. Clearly, however, state action can violate the Commerce Clause by directly regulating or discriminating against interstate commerce.[40] This Court has held that a State action directly burdens interstate commerce when it adversely affects commerce by subjecting activities to inconsistent regulations.[41] Similarly, this Court has held that no State may force an out-of-state seller to seek regulatory approval in one State before undertaking a transaction in another State.[42] The North Carolina decision ignores such holdings. Instead, North Carolina's decision plainly was intended to shield North Carolina

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[40] *Edgar v. MITE Corp.*, 457 U.S. 624, 643 (1982). *See also New England Power Co. v. New Hampshire*, 455 U.S. 331, 340-41 (1982) (holding that section of Federal Power Act was not an affirmative grant of power to the states to burden interstate commerce in a manner that would otherwise not be permissible, and stating that nothing in the Act evinced an intent to alter limits on state power otherwise imposed by the Commerce Clause).

[41] *CTS Corp. v. Dynamics Corp. of America*, 481 U.S. 69, 87-88 (1987).

[42] *Healy v. Beer Institute, Inc.*, 491 U.S. 324 (1989).

electric customers from costs imposed pursuant to Federal law, regardless of the effects on Virginia customers. Such effects include the subsidization of North Carolina ratepayers. The actions of North Carolina are precisely the kind of economic protectionism that is per se unconstitutional under the Commerce Clause.[43]

In this case the North Carolina court admitted that there were "inconsistent determinations of avoided costs by the VSCC and the [NCUC that] may burden NC Power." App. 11a. The court did not suggest that such burden was merely incidental, but concluded that such "burden is a necessary consequence of doing business in more than one state." App. 11a. Further, the North Carolina court held that there was no Commerce Clause violation because, by not appealing the VSCC order to the Virginia courts, Virginia Power "accepted the risk" that its Federally-imposed costs would be denied by the North Carolina commission. App. 11a.

The holding of North Carolina not only ignores the decisions of this Court, it conflicts with the decision of the Federal Eighth Circuit in *Middle South Energy, Inc. v. Arkansas Public Service Comm'n.*[44] In *Middle South* the Eighth Circuit held that a State utility commission's attempt to prohibit a utility's wholesale purchases of higher-cost power from an adjacent state created an unlawful preference under the Commerce Clause for citizens in the regulating jurisdiction. Here, in contrast, the North Carolina court achieved the same result attempted by the Arkansas commission by denying Virginia Power's recovery of costs of power purchased in an adjacent state. As the *Middle South* court recognized, this is plainly an unlawful preference for North Carolina customers over Virginia customers.

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[43] *Philadelphia v. New Jersey*, 437 U.S. 617, 621-28 (1978).

[44] 772 F.2d 404 (8th Cir. 1985), *cert. denied*, 474 U.S. 1102 (1986).

The decision of the North Carolina court that inconsistent regulatory decisions in the context of wholesale electric power transactions that effect a preference for North Carolina customers does not violate the Commerce Clause raises a substantial Federal question that should be reviewed by this Court.

CONCLUSION

The Court should grant Virginia Power's petition and set the case for full briefing and argument on the merits. The Federal issues are too substantial, and have too large an impact on the implementation of PURPA, for the North Carolina courts and regulators to be the only tribunals to consider them.

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